Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

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International Accounting Standards Board
Columbus Building
7 Westferry Circus
London, E14 4HD United Kingdom

Subject: ED/2019/7 – *General Presentation and Disclosures*

The Canadian Securities Administrators Chief Accountants Committee appreciates the opportunity to comment on the IASB's Exposure Draft on General Presentation and Disclosures ("the proposed amendments" or the "ED"). The Canadian Securities Administrators (CSA) is an organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets. The CSA Chief Accountants Committee (CAC) is comprised of the Chief Accountants from the provinces of British Columbia, Alberta, Ontario and Quebec.

We support the IASB's effort to improve how information about performance is communicated in the statement of profit or loss, and are generally supportive of the proposals in the ED. However, we have concerns on certain aspects of the ED as detailed in our responses below:

I. Management performance measures

General Comments

Performance measures are often used in practice outside of the financial statements and we acknowledge requiring disclosure of management performance measure (MPMs) within the financial statements may improve the relevance of financial statements. However, we are concerned that some aspects of the proposals would raise significant challenges, as discussed below.

Definition of Management Performance Measures - Proposed Paragraph 103

We are of the view that the term "management performance measures" as described in proposed paragraph 103 is not well defined and would be difficult to apply in practice. Specifically, we have the following concerns with the proposed definition:

- The proposed requirement in paragraph 103(b) that a MPM "*complement totals or subtotals specified by IFRS Standards*" is difficult to operationalise and enforce. It is unclear what is meant by the term "complement" and how an entity would determine whether an MPM "complements" totals or subtotals specified by IFRS standards. While we note that paragraph BC 151 states that MPMs "complement" measures specified by IFRS standards "by providing users with useful insight into management's view of performance", it still does not provide a clear definition.

- Notwithstanding our comment above, based on the discussion of "complement" in BC 151, it appears that the "complement" requirement in paragraph 103(b) is very similar to the concept in paragraph 103(c) of the proposed standard. Unless a different concept is meant to be conveyed in paragraph 103(b), we recommend the Board remove paragraph 103(b) or if a different concept is intended, we then recommend the Board further explain what is meant by "complement."

- Proposed paragraph 103(a) refers to "*public communications outside financial statements*", however the ED does not explain what constitutes public communication. Does public communication include all required and voluntary communication in paper and electronic form? We also question how this term extends to an entity's social media and oral statements or transcripts of oral statements made. We note that "made available to the public" is a common concept used in securities legislation and thus it may be confusing for entities to determine the difference between these two references. As currently drafted, it appears that the scope of "public communications outside the financial statements" would be quite broad and may create practical issues from an enforceability and auditability perspective. While paragraph B79 provides common examples of "public communications", the guidance is insufficient for an entity to determine which other types of communication it may make that are intended to be in scope. We recommend that the term "public communications outside financial statements" be clearly defined; or, if the Board retains the current wording, we recommend that the Board include a more extensive list of examples in the application guidance.

- The proposed requirements for MPMs are not specific with regards to the timeframe for assessing whether a MPM is in scope. When an entity uses a MPM in public communications outside financial statements and therefore must disclose information in a note to the financial statements, what timeframe should the entity consider regarding the use of the MPM in public communications outside the financial statements? For example, is the timeframe the same time period as the financial statements, or up until the filing date? We recommend that the Board clarify that the timeframe for MPMs should cover the same reporting period contemplated by the financial statements, or another timeframe if intended by the Board.

Terminology – Management Performance Measure

In Canada, the term "management performance measures" is used by many stakeholders to refer to a much broader set of measures than those captured by the definition in the ED. While we understand the term "performance" relates to the statement of financial performance, many users of financial reporting information are not familiar with the IFRS standards and IFRS terminology. Therefore, using the term "performance measure" may cause confusion, particularly for stakeholders who are unfamiliar with the accounting standards, and for entities subject to securities legislative requirements relating to other performance measures that are not captured by the ED definition. We suggest the Board use a different term, such as "management profit and loss measures" or "management income and expense measures."

Requirements for Management Performance Measures

- It is unclear how an entity would apply proposed paragraph 105(a), which requires MPMs to *"faithfully represent aspects of financial performance of an entity to users of financial statements..."* In particular, we note that the 2018 conceptual framework description of faithful representation encompasses the characteristics of complete, neutral and free from error. In our experience in reviewing the disclosure of these types of measures, they involve adjustments to amounts recognised and measured in accordance with IFRS and predominantly present more favourable results than the most comparable IFRS measures. Thus, it is questionable whether such measures are neutral. We think that a faithful representation requirement, and as an extension, that an MPM must be neutral, would result in very few MPMs qualifying for inclusion in the financial statements, which is contrary to the Board's objectives for the MPM proposals. We are also concerned with the potential diverse application of the requirements of neutrality by preparers and auditors which could result in inconsistent application of the proposals and therefore reduce comparability and consistency. Some could interpret paragraph 105(a) to narrow the scope of the measures that can be included in the financial statements, whereas others may not. We recommend the Board either reconsider the requirement for MPMs to be neutral or provide guidance on how to assess whether an MPM is neutral.

- Notwithstanding our concern with the neutrality element of faithful representation, we would like clarification on the application of paragraph 105(a) for "faithful representation" in conjunction with the definition of an MPM in paragraph 103, and the discussions in BC155, BC159(c), and BC161.

  Paragraph BC159(c) states that *"entities wishing to avoid the proposed disclosure requirements could do so by disclosing performance measures outside the financial statements that they believe would be assessed by their auditors or regulators as not providing a faithful representation."* Paragraph BC161 states *"A management-defined performance measure that does not faithfully represent an aspect of an entity's performance should not be included in the financial statements as a management performance measure".* However, BC155 indicates the Board considered, but rejected imposing specific restrictions on how MPMs are calculated, such as restricting measures to those based on amounts recognized and measured based on accounting policies that do not comply with IFRS Standards.

  If, as explained in BC155, the Board does not propose specific restrictions for the calculations of MPMs, it is our view the proposals would allow entities to present subtotals of income and expenses in the notes to the financial statements that may not be measured in accordance with the entity's accounting policies, potentially increasing the prominence of non-IFRS defined subtotals. In order to alert users that certain MPMs may be comprised of amounts which are not recognised and measured in accordance with the entity's accounting policies, we recommend requiring entities to clearly identify and describe the components of the reconciliation that are not recognised and measured in accordance with the entity's accounting policies.

- The definition of an MPM appears to be in paragraph 103 only. It is not clear whether paragraph 105 contains an additional limitation on what qualifies as an MPM. Is the intention of the proposed standard to require inclusion in the financial statements of only those MPMs that also meet the requirements of paragraph 105 (faithful representation and clear and understandable), and thus exclude certain performance measures that might otherwise be considered MPMs based on paragraph 103? If so, an entity could disclose numerous MPMs outside the financial statements but only those meeting the requirements of paragraph 105 are required to be disclosed in the notes to the financial statements? If this is the case, this may cause confusion for users and also reduce comparability amongst entities.

- Below are some examples of performance measures that we have observed in practice to help convey the concerns raised in the preceding paragraphs. We recommend the Board to consider whether the following examples would meet the requirements of paragraph 105(a):
    - an adjusted operating profit and loss measure calculated as IFRS operating profit and loss adjusted for pro forma adjustments; for example, in a business acquisition completed mid-year, the acquirer includes the financial results of the acquiree for the entire fiscal period including transactions prior to acquisition by the acquirer, where disclosure of such measure is not required by IFRS 3;
    - an adjusted operating profit and loss measure calculated as IFRS operating profit and loss adjusted to include revenue that may be earned relating to potential contracts with customers;
    - an operating profit and loss measure calculated to include adjustments that attempt to normalize the measure by removing anomalous items for a specified period but do not relate to transactions by the entity; for example, an adjustment for "bad weather".

  We encourage the Board to put forward more application guidance to address measures like the ones noted above.

- Proposed paragraph 105(b) states that MPMs must be described in a clear and understandable manner that does not mislead users. We recommend that the requirement that MPMs not be misleading should not be limited to the description of the MPM but also extended to the requirements in paragraph 106.

Proposed Paragraph 104

The subtotals specified by IFRS and listed in proposed paragraph 104 are not MPMs; we note that these represent only a subset of subtotals that can be presented on the statement of financial performance. We suggest noting in proposed paragraph 104 that this list is not exhaustive or remove the list of examples in this paragraph and include them in the application guidance instead.

Audit Considerations

Audit matters will be an important aspect of these requirements and should be considered as these proposals are finalized. For example, it will be important for auditors to understand how to assess completeness of MPMs - specifically, how to determine whether management has captured all MPMs used in public communications outside the financial statements. Also, auditors will need to consider whether management's disclosure of MPMs *"faithfully represent aspects of the financial performance of the entity to users of financial statements."* (paragraph 105 (a)), and whether there a sufficient explanation of "*how the MPM provides useful information about the entity's performance*" (subparagraph 106 (a) (ii)). Audit standard setters are therefore key stakeholders in this project; we encourage the Board to address any questions or concerns raised by audit standard setters to help ensure consistent application of the final requirements.

Communication with the SEC

For the many issuers that file in their home jurisdiction and the U.S., it is important that the SEC continue to permit financial statements prepared using IFRS as issued by the IASB. There are many such cross-border issuers in Canada. We encourage the Board to proactively communicate with the SEC to ensure that the proposed changes in the ED do not cause the SEC to alter its approach to permit use of IFRS by foreign issuers.

II. Analysis of operating expenses

Analysis by nature or function

Currently IAS 1 encourages, but does not mandate, the presentation of an analysis of expenses by nature or by function in the statement of profit or loss. Paragraph 68 of the ED proposes to require presentation of an analysis of expenses by nature or by function in the operating category of the statement of profit or loss, whichever provides the most useful information to users of the financial statements. The vast majority of entities we regulate currently present expenses in the statement of profit or loss using a mixed presentation and we are not aware of any demand in our market to mandate either a by nature or by function presentation. Many small issuers in the Canadian market do not generate significant revenue, so we foresee that these entities could easily conclude that either by nature or by function provides the most useful information to users. As paragraph 72 requires the analysis of expenses by nature in the notes to the financial statements, we anticipate many issuers will present expenses by nature in the statement of profit and loss, rather than by function. Compared to the current practice of a mixed presentation this will result in less information of expenses by function provided to users. We are also concerned stakeholders in Canada may react negatively to the proposed change as it may result in reduced comparability to U.S. companies. In addition, mandating presentation of expenses by nature or by function may cause entities to increase their use of MPMs, further decreasing the prominence of IFRS specified information. As investors in Canada find a hybrid presentation useful, we recommend the IASB accommodate the current practice in allowing flexibility in of the analysis of expenses in the statement of profit and loss.

We also note that paragraph B47 requires the presentation of minimum line items on the face of the income statement regardless of the by function or by nature choice. In addition to B47, it seems a mixed presentation could arise as a result of proposed paragraphs B15. We recommend that the Board clarify the role of a mixed basis of presentation, if any.

III. Unusual income and expenses

We generally support the concept of separate disclosure of unusual income and expense items, although we note the following areas where additional guidance would be helpful.

Definition of 'unusual income and expenses'
The definition of "unusual" hinges on expectations about the future and we note the proposed definition of unusual income and expenses refers to "several future annual reporting periods." Additional guidance on how an entity should interpret "several" would help regulators and auditors oversee an entity's compliance with the standard. For example, under disclosure guidance in Canada for describing adjustments in non-GAAP financial measures, an entity does not describe adjustments as non-recurring, infrequent or unusual when a similar loss or gain is reasonably likely to occur within the next two years or has occurred during the prior two years. In addition, we suggest a more precise definition that also takes into consideration past occurrences of same or similar income or expenses. In this regard, we note that both the European Securities and Markets Authority and International Organization of Securities Commissions guidance include past occurrences as part of the determination of whether an item of income or expense is unusual.

Comparative information
Paragraph B74 appears to provide guidance on whether the reporting entity is required to identify comparative information as "unusual" where the reporting entity identifies an item as "unusual" in the current year. We suggest that the Board also provide guidance to address the situation where an entity in the prior year identifies an income or expense item as "unusual" but determines in the current year that the item no longer meets the definition. In that scenario, is the entity required to restate comparatives?

Disclosure required
Paragraph 101 proposes to require disclosure of all unusual income and expenses in a single note to the financial statements. However, it is unclear whether an entity is permitted to present unusual income or expense line items in the statement of profit or loss by referring to "unusual line items". Further, BC56 indicates that the Board does not view predictive value as a characteristic that differentiates whether income or expense are operating (or another category), suggesting that unusual items may be separately presented across the different categories. We suggest the Board clarify within the standard whether or not entities can present unusual items in the statement of profit or loss by referring to "unusual line items" and/or a subtotal of unusual income and expenses within the categories defined by the Board.

IV. <u>Proposed categories of income and expenses (Questions 1 to 6 of the ED)</u>

The ED proposes six categories for income and expenses included in profit or loss (IAS 1.45); three of the categories are operating, investing or financing. We understand that the proposed standard does not require use of these terms as headings on the face of the statement of profit or loss, but based on current practice, we expect most entities would use the terms "operating" and "financing" as part of the caption for certain subtotals. Page 8 of the ED notes that the Board developed its proposals for the categories without trying to align classifications across the primary financial statements and consequently the income and expenses classified in the operating, investing and financing categories in the statement of profit or loss do not necessarily correspond with the cash flows from operating, investing and financing activities in the statement of cash flows. We appreciate that the objectives of the statement of cash flows differ from the objectives of the statement of profit or loss, but we think using the same terms differently will be confusing. We urge the IASB to avoid such confusion.

We note that given the inconsistent use of terminology between the proposed statement of financial performance and the statement of cash flows, changing the starting point for the "indirect method" from "profit or loss" to "operating profit or loss" could also create confusion. (Proposed IAS 7, paragraphs 18(b) and 20).

Operating Category

General comments

We generally support the proposal to require all entities to present a subtotal for operating profit or loss. It is a fairly common subtotal that we see in practice and we often see a lack of consistency in its use, labelling and definition. We anticipate that the proposed requirement will reduce this diversity and improve comparability of financial statements.

Definition of the operating category

We request additional guidance on the concept of "main business activity" and "in the course of the entity's main business activity", as these terms are not clearly defined, and the allocation of income and expense to these categories is dependent on the application of these concepts which might involve significant judgment. We note that the terminology proposed differs from existing terms used in IFRS for similar concepts, for example IFRS 15 *Revenue from Contracts with Customers* (IFRS 15) defines revenue as income arising in the course of any entity's "ordinary activities", and IFRS 8 *Operating Segments* refers to "business activities" from which an entity may earn revenues and incur expenses, whose operating results are regularly reviewed by the entity's chief operating decision maker. An explanation of how the proposed terms interact with existing terminology would help entities apply the standard.

Investing category

Generally, we think that a separate investing category can provide useful information to users of financial statements about the returns from investments that are not part of the entity's main business activities, particularly for non-financial institutions. As noted above, we recommend that the Board clarify the meaning and application of the concept of "in the course of the entity's main business activities."

Other comment relating to the proposed categories

We question whether the anticipated benefit of requiring entities to classify foreign exchange differences in the same category of the statement of profit or loss as the related item (proposed paragraph 56) exceeds the additional cost to entities to present such information. We suggest the Board consider an explicit option within the standard for entities to classify all foreign exchange items in a single line item.

V. Roles of the primary financial statements and the notes

Proposed paragraph 19 identifies two objectives of financial statements: to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing 1) the prospects for future net cash inflows, and 2) management's stewardship of the entity's economic resources.

We are concerned that the focus on "future net cash inflows" is narrower than OB 2 of the conceptual framework for financial reporting, which identifies that the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors making decisions about providing resources to the entity. We suggest expanding the objectives in proposed paragraph 19 to also refer to the financial position and the financial performance of an entity, consistent with IAS 1, paragraph 9.

Also, proposed paragraph B4(b) states that in applying paragraph 21(b), an example of how an entity supplements the primary financial statements is by including information about an entity's exposure to various types of risk such as market risk or credit risk, arising from both recognized and unrecognized elements of the financial statements. The scope of such "unrecognised elements", and the relationship to the objective of financial statements, are not clear. Information about the entity's exposure to various types of risks is a very broad requirement and as currently written, paragraph B4(b) appears to extend to any and all potential risks that an entity could face, which could be limitless, and goes beyond the objective and role of the financial statements. We recommend that the IASB narrow the scope of paragraph B4(b) to information required by specific requirements of other primary IFRS (e.g. the risk disclosures required in IFRS 7).

VI. Proposed amendments relating to integral and non-integral associates and joint ventures

We do not think it is necessary to explicitly require an entity to present in the statement of profit or loss a separate line item relating to integral associates and joint ventures because an entity is already required to present the separate line item under proposed paragraph 42, if it is relevant to an understanding of the entity's financial performance. However, if the Board proceeds with the proposals, we recommend including additional application guidance as we think it is not clear how an entity would apply the proposed requirements to determine whether a joint venture or associate is integral to the entity's main business activities or non-integral. In particular, we note the term "interdependency" may be difficult to apply on a consistent basis. As well, it would be helpful to clarify how "significant interdependency", as used in the proposed standards compares to the IFRS 15 concept of "highly interrelated or interdependent."

It is also unclear how an entity diversifying into a related but new industry (example, an oil and gas company creating a transportation business through a JV or associate) should apply the indicators in proposed IFRS 12, paragraph 20D.

VII. <u>Illustrative examples</u>

Proposed paragraph 106 requires an entity to disclose for each MPM an explanation of how the measure provides useful information about the entity's performance. However, Note 2 to Part 1 of the Illustrative examples (page 12) discloses, "The Group believes that its management performance measures help users of financial statements to assess underlying trends in profitability including the effect of acquisitions on the profitability of the Group." It is unclear how the illustrative note disclosure, with only one explanation on the usefulness of three MPMs, complies with paragraph 106. In addition, in our view, this description of how the MPM provides useful information about the entity's performance is not specific. In Canada, entities who disclose a non-GAAP financial measure also explains why the non-GAAP financial measure provides useful information to investors and what additional purposes, if any, for which management uses the non-GAAP financial measure. In our experience reviewing entities' disclosures, disclosure about usefulness is consistently noted as a common deficiency. To help auditors and regulators oversee the proposed requirements for MPMs, we recommend that the Board provide high-quality examples that are entity-specific and avoid boilerplate disclosure.

If you have any questions about this letter, please do not hesitate to contact us.

Yours truly,

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